

Decision **ALTERNATE DRAFT DECISION OF COMMISSIONER KENNEDY**
(Mailed April 20, 2005)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Joint Application of Lynch Telephone Corporation XI, Lynch Interactive Corporation, Brighton Communications Corporation, Cal-Ore Telephone Co. (U-1006-C), and California-Oregon Telecommunications Corporation to Authorize the Acquisition of Indirect Control of Cal-Ore Telephone Co. (U-1006-C) by Lynch Telephone Corporation XI, Lynch Interactive Corporation, and Brighton Communications Corporation through their Acquisition of Control of California-Oregon Telecommunications Company.

Application 04-05-039
(Filed May 25, 2004)

**DECISION GRANTING CONDITIONAL AUTHORITY FOR
LYNCH INTERACTIVE CORPORATION TO ACQUIRE
INDIRECT CONTROL OF CAL-ORE TELEPHONE CO.
AND CAL-ORE LONG DISTANCE, INC.**

O P I N I O N

Summary

This Decision grants conditional authority under Pub. Util. Code § 854¹ to transfer indirect control of Cal-Ore Telephone Co. (Cal-Ore) and Cal-Ore Long Distance, Inc. (COLD) from California-Oregon Telecommunications Company (COTC) to Lynch Interactive Corporation *et al.* The authority granted by this Decision is subject to the conditions in Appendix A.

Procedural Background

The following parties jointly filed Application (A.) 04-05-039 on May 25, 2005: Lynch Interactive Corporation, Brighton Communications Corporation, Lynch Telephone Corporation XI (together “Lynch”), COTC, and Cal-Ore (referred to collectively hereafter as “Joint Applicants”). In A.04-05-039, the Joint Applicants request authority for Lynch Telephone Corporation XI to acquire COTC, the parent company of Cal-Ore. The Joint Applicants submitted additional information on July 30, September 24, September 27, November 24, and November 29, 2004, and on February 10 and February 14, 2005, mostly in response to rulings issued by the assigned Administrative Law Judge (ALJ). Notice of A.04-05-039 appeared in the Commission’s Daily Calendar on May 28, 2004. There were no protests or other responses to the Application.

Description of the Joint Applicants

Cal-Ore is a small incumbent local exchange carrier (ILEC) with approximately 2,600 access lines in four exchanges located in Siskiyou and Modoc

¹ All statutory references are to the Public Utilities Code unless otherwise indicated.

Counties. The region served by Cal-Ore consists of rural areas and small towns.² Cal-Ore's revenues in 2003 were \$5.3 million. Cal-Ore has approximately 130 miles of fiber and 500 route miles of copper. It utilizes two Nortel DMS-10's for switching. Cal-Ore can reach approximately 75% of its customers with DSL and has more than 300 DSL subscribers.

Cal-Ore was purchased in 1950 by Bob and Marion Edgar. At first they provided service only within the town of Dorris, but over the years they built facilities to serve outlying farms and ranches. Later, the Edgars funded Cal-Ore's purchase of the telephone facilities for the town of Macdoel. In 1984 they purchased the Tulelake and Newell exchanges. The Edgars are now in their 80's and due to their age and health, they wish to transfer ownership of their company.

Cal-Ore is a California corporation. It is owned by COTC, which is also a California corporation. COTC's other holdings include COLD, Cal-Ore Cellular Company, Cal-Ore Wireless, Inc., and High Desert G.P. All are 100% owned by COTC, except High Desert G.P., which is jointly owned by COTC and High Desert Investment Group, LLC.³ COTC is owned by several trusts controlled by members of the Edgar and Graham families.

Lynch Interactive Corporation (Lynch Interactive) is a publicly traded⁴ telecommunications holding company based in Rye, New York. It had \$87.5 million of revenues in 2003. Its subsidiary, Brighton Communications Corporation (Brighton), owns fourteen rural ILECs in nine states outside of California.⁵ These

² Cal-Ore serves the municipalities of Dorris, Macdoel, Tulelake, and Newell, which have a population of 886, 140, 1,020, and 300, respectively. (Supplement filed Sept. 27, 2004, p. 4.)

³ A.04-05-039, Exhibit 1, Seller's Disclosure Schedule, Section 2.1(d).

⁴ Lynch Interactive is traded on the American Stock Exchange under the symbol "LIC."

⁵ The nine states are Iowa, Kansas, Michigan, New Hampshire, New Mexico, New York, North Dakota, Utah, and Wisconsin.

ILECs range in size from approximately 900 access lines in New Hampshire to over 13,000 in New York. As of December 31, 2004, the total access lines were 53,145.

Lynch Telephone Corporation XI (Lynch XI) is a wholly-owned subsidiary of Brighton and was established to be the acquiring entity and holding company of COTC. The Joint Applicants represent that Lynch seeks to acquire COTC to ensure that Lynch's telephone business remains strong and continues to grow through the acquisition of other telephone companies.

Lynch Interactive, Brighton, and Lynch XI are all Delaware corporations. They do not conduct business in California and will not conduct business in California as a result of the transaction. COTC and its subsidiaries will continue to conduct business in California after the consummation of the transaction.

The Proposed Transaction

In A.04-05-039, the Joint Applicants request authority under § 854(a) for Lynch XI to purchase all of COTC's preferred and common stock for \$21.2 million in cash and promissory notes. The cash portion will be \$14.0 million, and the promissory notes will total \$7.2 million. Lynch plans to obtain the \$14.0 million of cash paid to COTC's stockholders by issuing a like amount of debt.

The Joint Applicants represent that no material public utility assets will be sold as a result of the transaction. Cal-Ore and COLD will remain wholly-owned subsidiaries of COTC. The book value of Cal-Ore's property dedicated to public service will not be affected by the transaction. There will no change to the names of Cal-Ore and COLD, and no material changes in the operations of these companies. Nor will there be any changes to rates, terms, and conditions of the services offered by Cal-Ore and COLD. Lynch also intends to retain the current non-shareholder employees of Cal-Ore and COLD.

Section 854 and the Standard of Review

Application 04-05-039 requests authority to transfer indirect control of Cal-Ore and COLD. The transfer of these two public utilities is subject to § 854(a)⁶ which states, in relevant part, as follows:

§ 854(a): No person or corporation...shall merge, acquire, or control...any public utility...doing business in this state without first securing authorization to do so from the commission...Any merger, acquisition, or control without that prior authorization shall be void and of no effect.

The transfer of COTC's other assets and operations, including its wireless assets and operations, is not subject to § 854(a).⁷

The purpose of § 854(a) is to enable the Commission to review a proposed transaction, before it takes place, subject to a broad "public interest" standard.⁸ As we have previously explained, "ordinary transactions that are subject to section 854(a) should be approved absent a compelling reason to the contrary."⁹ Where it

is necessary and appropriate, the Commission may attach conditions to a transaction in order to protect and promote the public interest.¹⁰

⁶ A.04-05-039 is not subject to §§ 854(b), (c), and (f), since none of the parties to the transaction has gross annual California revenues exceeding \$500 million.

⁷ The Joint Applicants represent that Lynch will only acquire a minority interest COTC's wireless assets and operations. (Supplement filed July 30, 2004, p. 18.) Consequently, there is no transfer of control with respect to these entities that requires Commission approval pursuant to § 854(a). Further, in D.95-10-032, Ordering Paragraph (OP) 3, the Commission held that § 854 should not apply to wireless entities. If appropriate, the Joint Applicants should update the wireless registration information currently on file at the Commission with respect to COTC's wireless operations in California. (Ibid.)

⁸ See, e.g., D.01-06-084, in which the Commission stated that the "relevant inquiry is whether the proposed transaction is in the public interest."

⁹ D.04-04-018

¹⁰ D.01-06-007, 2001 Cal. PUC LEXIS 390, *24.

In assessing the public interest in this transaction we note the following factors:

- a. The transaction is unopposed.
- b. The sellers are elderly individuals whose age and health make it difficult for them to continue to manage Cal-Ore.
- c. The buyer is a public corporation with substantial assets and extensive experience in operating rural LECs like Cal-Ore.
- d. The buyer plans to make no changes in the operations or staffing of Cal-Ore other than those necessitated by the retirement of the sellers.
- e. Because this is purely a financial transaction that does not involve any physical change in the utility, it can be seen with certainty that the transaction has no adverse environmental impacts.

One aspect of the proposed sale that has received extensive consideration by the ALJ is the financing structure. The \$21.2 million of debt incurred by Lynch to acquire COTC will come from two sources. First, Lynch will obtain \$14.0 million of debt from third parties, such as banks. This debt could have a variable interest rate, a fixed rate, or a combination of the two. Lynch anticipates the variable interest rate will be approximately 5%, and the fixed interest rate will be approximately 7%. The second source of debt will be \$7.2 million of notes issued by Lynch to the current owners of COTC. The interest rate on these notes will be 8% for the first year, 9% for the second year, and 10% for the next three years.¹¹ Based on the business case presented by the joint applicants, COTC will generate enough free

¹¹ Supplement filed July 30, 2004, pp. 8 - 9.

cash to cover debt service and provide a small additional cash flow to Lynch. The Joint Applicant's business case is summarized in the following table:

TABLE 1 Surplus Cash Generated by COTC Assuming (1) \$14 Million of Debt, and (2) Annual Capital Expenditures of \$800,000 \$ 000					
	2005	2006	2007	2008	2009
Net Cash Flow from Operations ¹	2,805	2,769	2,732	2,694	2,655
Less: After-tax Debt Service @ 5% Interest ¹	(1,576)	(1,540)	(1,505)	(1,470)	(1,434)
= Cash Available for Capital Expenditures	1,229	1,229	1,227	1,224	1,221
Less: Capital Expenditures of \$800,000 ¹	(800)	(800)	(800)	(800)	(800)
= Cash Surplus After Capital Expenditures:	429	429	427	424	421
Net Cash Flow from Operations ¹	2,805	2,769	2,732	2,694	2,655
Less: After-tax Debt Service @ 7% Interest ¹	(1,738)	(1,690)	(1,640)	(1,590)	(1,540)
= Cash Available for Capital Expenditures	1,067	1,079	1,092	1,104	1,115
Less: Capital Expenditures of \$800,000 ¹	(800)	(800)	(800)	(800)	(800)
= Cash Surplus After Capital Expenditures:	267	279	292	304	315
Note 1: Source of information is Supplement filed on November 22, 2004					

The Joint Applicants' cash-flow projection for COTC shown in Table 1, above, is based on Cal-Ore's 2004 test-year revenues and expenses approved by the Commission in Resolution T-16762, issued on October 30, 2003. The projected net cash flow from operations for 2005 – 2009 assumes no growth in revenues and an annual increase in expenses of 2%. Table 1 shows that in 2009, COTC will generate a net cash surplus of \$421,000 if the interest rate on \$14.0 million of debt is 5%, and a net cash surplus of \$315,000 if the interest rate is 7%.

Joint Applicant's also represent that COTC's currently outstanding long-term debt of approximately \$6.5 million will be paid off when the transaction is closed

using COTC's cash and liquid assets.¹² COTC had \$2.2 million of cash on December 31, 2003, a certificate of deposit for \$1.6 million, and marketable securities in the amount of \$4.5 million.¹³

Table 1 omits the \$7.2 million of promissory notes that Lynch will issue to the current owners of COTC. When asked why this debt had been omitted from the schedule of COTC's debt, the Joint Applicants responded as follows:

“[Table 1] does not include debt owed to the sellers because that debt will not be at the [Cal-Ore] or the [COTC] company level. The seller debt will be higher in the corporate structure at the Lynch Telephone Company XI level. [Table 1] only includes debt that will be either at the Cal-Ore or COTC level.” (Email sent by the Joint Applicants to the ALJ on November 29, 2004.)

In other words, as to this \$7.2 million, the **buyer** (Lynch) is the debtor and the **seller** (Cal-Ore) is the creditor. The promissory notes will appear as an obligation on Lynch's books, not on COTC's books.

Third, Table 1 projects that capital expenditures will be \$800,000 per year after COTC is acquired by Lynch. This is substantially less than Cal-Ore's historical capital expenditures. Appendix B of today's Decision shows that Cal-Ore's capital expenditures averaged \$1.9 million per year during the six-year period of 1998 –

2003, and \$2.9 million per year during the three-year period of 2001 – 2003.

Although the record is silent on this point, in their comments on the ALJ's proposed decision, Joint Applicants argue that lower capital expenditures in the next few years reflect the heavy level of capital investment in the past few years. In other

¹² Supplement filed July 30, 2004, p. 10.

¹³ Supplement filed July 30, 2004, Exhibit E.

words, because Cal-Ore has spent heavily on capital projects in the recent past, it can spend substantially less on such projects in the near future.

Finally, we note that as of year-end 2003, the most recent date for which Lynch's audited financials statements are available in the record, Lynch had over \$26 million of cash and cash equivalent securities on its balance sheet. Simply put, Lynch could have chosen to buy Cal-Ore without borrowing any money but chose to use debt as part of an overall corporate financing strategy. In view of the strength of Lynch's balance sheet, there is little reason to suppose that Lynch will have difficulty servicing either the third-party debt or the promissory notes used to effect this purchase.

For the preceding reasons, we conclude that the proposed transaction is unlikely to have any adverse effects on the financial condition of COTC and Cal-Ore. To provide additional safeguards against the possibility of such effects, we will approve A.04-05-039 with the following conditions¹⁴:

1. Lynch and COTC shall provide Cal-Ore with sufficient equity capital to (i) maintain a reasonable and balanced capital structure, and (ii) provide service to the public that is safe, reliable, and in compliance with all applicable statutes and Commission orders.
2. Cal-Ore shall establish and maintain a policy for managing its finances on a stand-alone basis, independent of COTC, Lynch, and other affiliates.
3. Cal-Ore shall not loan money, pay a dividend, pay a management fee, or transfer other money to COTC, Lynch, or other affiliates if

¹⁴ Many of the adopted conditions are similar to conditions adopted by the Commission in one or more of the following decisions: D.01-06-084, Appendix A; D.01-06-007, Appendix B; D.00-05-047, OP 2a; D.99-04-068, OP 8; D.98-06-068, attached Settlement, Item 11; D.98-03-073, Appendix B, Item IV.A; D.96-07-059, OPs 20 – 23; D.96-07-025, OP 5; D.95-12-018, OPs 5 - 7; D.95-11-024, Finding of Fact 26; D.94-09-080, OP 4; D.91-09-068, OP 1a; D.91-09-067, OP 1a; D.88-01-063, OPs 9 – 12; and D.86-03-090, OPs 12- 15.

doing would jeopardize Cal-Ore's ability to provide safe and reliable service to the public at reasonable rates.

4. Cal-Ore shall not record a premium for regulatory accounting purposes, where the premium is the excess of purchase price over book value.
5. Cal-Ore shall not increase rates for its customers due to any increase in costs associated with the sale/purchase of COTC.
6. Regardless of the amount of debt that Lynch and COTC may decide to allocate to Cal-Ore, the Commission may impute a reasonable and balanced capital structure for Cal-Ore for regulatory accounting and ratemaking purposes.¹⁵

Our authority to adopt the previous conditions is well established, as is our authority to regulate a utility's financial transactions.¹⁶

We conclude for the following reasons that it is reasonable to grant authority under § 854(a) to transfer indirect control of Cal-Ore to Lynch. First, the transfer will not affect Cal-Ore's ratepayers because there will be no change to Cal-Ore's name, local management, operations, utility rates, or services. Second, although the record suggests that there is little reason to believe that this transaction will have any adverse effects on Cal-Ore or its ability to serve the public, this Decision imposes several additional safeguards to protect the public. With these additional safeguards, we conclude that the public will not be harmed by the transaction.

¹⁵ Capital structure is composed of long-term debt, preferred stock, and common equity. It excludes short-term debt. (D.01-02-011, Fn. 34, 2001 Cal. PUC LEXIS 224, *32; D.00-06-040, *mimeo.*, p. 10.) In D.97-04-036, Conclusion of Law 3, the Commission held that Cal-Ore's capital structure of 39.98% debt and 60.02% equity was reasonable. (71 CPUC 2d 596, *50.) Cal-Ore's capital structure on June 30, 2003, was 47.88% debt and 52.12% equity. (Supplement filed on November 22, 2004, Exhibit F.) Today's Decision takes no position on the reasonableness of Cal-Ore's current capital structure. In the future, Cal-Ore will have the burden of demonstrating the reasonableness of any capital structure that deviates from that found reasonable by the Commission in D.97-04-036.

¹⁶ D.01-06-007, Cal. PUC LEXIS 390, *54

Third, the public might benefit from the transaction if it enhances Cal-Ore's ability to raise capital as the Joint Applicants allege. This could help Cal-Ore to maintain, improve, and expand its services in California. Finally, California reaps enormous benefits from the services provided by public utilities. Thus, it is in the public interest to foster a business climate in California that is hospitable to utilities. Accordingly, as we noted above, transactions that are subject to § 854(a) should be approved absent a compelling reason to the contrary. With the conditions adopted by this Decision, we are not aware of any reason why the transaction should not be approved.

Gain On Sale

Lynch intends to purchase COTC for \$21.2 million.¹⁷ The shareholders of COTC will realize a net gain from the sale of COTC equal to the sales price of \$21.2 million less any taxes, transaction costs, contingent adjustments to the purchase price, and the shareholders' investment in COTC.¹⁸ The Joint Applicants argue that Commission precedent and court decisions require that COTC's shareholders receive the entire gain from the sale of COTC.

In situations involving the sale of an entire utility, as is the case here, we have always allocated to shareholders the gain or loss from the sale.¹⁹ Therefore,

consistent with our precedent, we will allocate to COTC's shareholders the entire gain from the sale of Cal-Ore.²⁰

¹⁷ A.04-05-039, Exhibit A, page 1.

¹⁸ There is no record in this proceeding regarding the amount of the shareholders' gain.

¹⁹ D.01-06-007, 2001 Cal. PUC LEXIS 390, *154.

²⁰ The public might also receive a portion of the gain via the taxes that the owners of COTC may have to pay on the gain.

The approach that the Commission has taken in allocating gain-on-sale should not be confused with the allocation of other benefits from a transaction. With respect to certain transactions (not including this one), § 854(b)(2) requires that ratepayers receive an equitable allocation of the transaction's benefits. Even in transactions not explicitly covered by § 854(b)(2) the Commission has sometimes allocated a portion of the transaction benefits to ratepayers. However, those cases did not involve an allocation of any gain on sale. They involved a quantification of economic benefits of a transaction and an allocation of an equitable share of those benefits to ratepayers. Because Cal-Ore is a cost-of-service utility the Commission will be able to pass the economic benefits of the transaction, if any, to ratepayers through normal ratemaking processes. Thus, there is no need at this time to identify and allocate the transaction benefits.²¹

We recognize that Cal-Ore has received ratepayer-funded subsidies from intercompany settlements and, more recently, the California High Cost Fund A (CHCF-A). These subsidies were included in Cal-Ore's revenue requirement and used to recover its cost of service. If these subsidies had not been available, Cal-Ore would have had to recover its revenue requirement from its customers. Thus, the subsidies ultimately flowed to Cal-Ore's customers, since Cal-Ore's customers received telephone service at rates well below the cost of providing that service. There was no windfall for Cal-Ore's shareholders, and the subsidies that flowed directly to Cal-Ore's ratepayers did not provide ratepayers with an ownership interest in Cal-Ore.

²¹ Cal-Ore's next general rate case filing should separately identify and describe the economic benefits of the transaction, if any, so that the benefits may be flowed through to ratepayers.

Accordingly, all the gain-on-sale should be allocated to shareholders in accordance with longstanding precedent.

Authority to Transfer Indirect Control of Cal-Ore Long Distance, Inc.

Cal-Ore Long Distance, Inc. (COLD), which is owned by COTC, is authorized to provide resold interexchange services in California pursuant to D.01-04-002. In A.04-05-039, the Joint Applicants request authority under § 854(a) for Lynch to acquire indirect control of COLD.²²

Lynch does not possess a Certificate of Public Convenience and Necessity (CPCN) to provide telecommunications services in California. In situations where a company acquiring a telecommunications utility does not possess a CPCN, the Commission requires the acquiring entity to satisfy the same criteria as an applicant seeking a CPCN to exercise the type of authority held by the utility being acquired.

Lynch must satisfy four requirements to obtain a CPCN like that held by COLD. First, Lynch must have a minimum of \$ 25,000 in cash or cash equivalent. Application 04-05-039 contains pieces of Lynch's financial statements, and the included pieces demonstrate that Lynch has more than \$25,000 in cash.²³

Second, Lynch must have demonstrated technical expertise in the operation of a telecommunications utility or related business. Lynch satisfies this requirement due to its ownership of 14 rural ILECs.

Third, Lynch should not have a history of regulatory misconduct, business malfeasance, or business incompetence. In response to a routine inquiry from the

Commission, Lynch represents that no affiliate, officer, director, partner, or owner of more than 10% of any of the Lynch companies, or any person acting in that

²² Supplement filed July 30, 2004, p. 19.

²³ A.04-05-039, Exhibit 5.

capacity, has been (1) sanctioned by the Federal Communications Commission (FCC) or a state regulatory commission for violating a regulatory statute, rule, or order²⁴; or (2) found criminally or civilly liable for a violation of § 17000 *et seq.* of the California Business and Professions Code or for misrepresentations to consumers, or is currently under investigation for such misconduct

Finally, the Commission considers if the proposed transaction will adversely affect the customers of the utility being acquired. The Joint Applicants represent that the proposed transaction will not result in a change to COLD's name, management, or the rates, terms, and conditions of services offered by COLD. Based on this information, we concluded that COLD's existing customers will not be adversely affected by the proposed transaction.

We find that the proposed transfer of control of COLD to Lynch satisfies the Commission's requirements. Therefore, we will approve the transfer.

Environmental Assessment

Pursuant to the California Environmental Quality Act (CEQA)²⁵ and Rule 17.1 of the Commission's Rules of Practice and Procedure (Rule), we must consider the environmental consequences of projects that are subject to our discretionary approval. Thus, in deciding whether to approve A.04-05-039, we must consider if doing so will alter an approved project, result in new projects, change facility operations, etc., in ways that have an environmental impact. The Joint Applicants state that because the proposed transaction involves only a change

²⁴ Lynch notes that Gabelli Funds, Inc. (GFI), a registered investment advisor, and Mario J. Gabelli, the CEO of GFI and the current CEO of Lynch Interactive, entered into a consent agreement in 1993 with the FCC pursuant to which, without admitting any violation and without the impositions of any fines or other sanctions, they agreed to comply with certain FCC regulations with respect to the media interests of GFI's clients.

²⁵ Pub. Res. Code § 21080.

in ownership of COTC, there is no possibility that the transaction will have any significant adverse effect on the environment.

The record of this proceeding indicates that approval of A.04-05-039 will not have a significant effect on the environment. In particular, the Application does not request authority for new construction, and the Joint Applicants represent that they have no plans to undertake new construction, change the operations of COTC or its subsidiaries, or change the use of existing assets and facilities.²⁶ Therefore, it can be seen with certainty that the proposed transaction will not have a significant effect on the environment and, for this reason, qualifies for an exemption from CEQA pursuant to Section 15061(b)(3)(1) of the CEQA guidelines.²⁷ Consequently, there is no need for further environmental review. Of course, if the Joint Applicants decide in the future to undertake any new construction, change the operations of COTC or its subsidiaries, or change the use of Cal-Ore's existing assets and facilities, the Joint Applicants will have to fully comply with any applicable CEQA requirements.

Comments on the Draft Decision

The draft Decision of the assigned ALJ was mailed to the service list in accordance with § 311(g)(1) and Rule 77.7. Comments on the draft decision were filed on March 23, 2005, by Lynch and jointly by Cal-Ore and COTC. There were no reply comments. These comments have been reflected, as appropriate, in the final Decision adopted by the Commission.

Categorization and Need for Hearings

In Resolution ALJ 176-3135, dated June 9, 2004, the Commission preliminarily categorized this proceeding as ratesetting and preliminarily determined that

²⁶ Supplement filed July 30, 2004, p. 15.

²⁷ Section 15061(b)(3)(1) of the CEQA guidelines states: "Where it can be seen with certainty that there is no possibility that the activity in question may have a significant effect on the environment, the activity is not subject to CEQA."

hearings were not necessary. Based on the record of this proceeding, we affirm and finalize the determinations regarding categorization and the need for hearings that were made in Resolution ALJ 176-3135.

Assignment of Proceeding

Geoffrey F. Brown is the Assigned Commissioner and Timothy Kenney is the assigned ALJ in this proceeding.

Findings of Fact

1. COTC is a holding company that owns Cal-Ore and COLD. Cal-Ore represents the majority of COTC's revenues and assets.
2. Cal-Ore is a small ILEC with approximately 2,600 access lines. Cal-Ore had \$5.3 million of revenues during 2003.
3. Lynch Interactive is a publicly held company that owns 14 small ILECs in nine states outside of California. It had \$87.5 million of revenues in 2003.
4. Application 04-05-039 requests authority under § 854(a) for Lynch to purchase COTC in accordance with the Stock Purchase Agreement appended to A.04-05-039. If approved, the transaction will result in Lynch obtaining control of Cal-Ore and COLD.
5. In the Stock Purchase Agreement, Lynch has agreed to purchase COTC for \$21.2 million of cash and promissory notes. The cash portion will be \$14 million, and the promissory notes will total \$7.2 million.
6. The Joint Applicants represent that the purchase of COTC by Lynch will not result in (i) the sale or disposal of any material public utility assets, or (ii) changes to any of the following: (a) the rates, terms, or conditions for any utility service, (b) the manner in which any utility service is provided, (c) the book value of Cal-Ore property dedicated to public service, and (d) the management, managers, and operation of Cal-Ore.

7. Lynch intends to purchase COTC using 100% debt financing.
8. The \$21.2 million of debt incurred by Lynch to acquire COTC would be in addition to COTC's existing long-term debt, which amounted to \$6.5 million on December 31, 2003. Cal-Ore accounts for most or all of COTC's long-term debt.
9. Lynch's purchase of COTC for \$21.2 million using 100% debt financing will not negatively affect the financial condition of Lynch, COTC, and Cal-Ore.
10. The quality of service provided by Cal-Ore will be maintained if A.04-05-039 is approved.
11. The technical competence of Cal-Ore's management will be maintained and possibly improved by Lynch's acquisition of COTC.
12. The Commission has received no complaints or expressions of concern from Cal-Ore employees regarding the sale of COTC.
13. The Joint Applicants represent that Lynch's purchase of COTC will not initially affect the compensation or benefits of any of the non-shareholder employees of Cal-Ore, and that the transaction will provide Cal-Ore employees with access to better training and career opportunities because they will be a part of a much larger family of companies.
14. The Joint Applicants represent that Lynch's purchase of COTC will not result in an immediate reduction in the number of Cal-Ore's non-shareholder employees, and that all current Cal-Ore jobs will remain in the local community.
15. The Stock Purchase Agreement appended to A.04-05-039 states that it is Lynch's intent to offer continued employment to COTC's non-shareholder employees on substantially the same terms in effect as of the Closing Date.
16. The proposed transaction is fair and reasonable to Cal-Ore's employees for the reasons set forth in the four previous FOFs.
17. The proposed transaction has been approved by COTC's shareholders.

18. Lynch has provided notice of the proposed transaction in its annual report to its shareholders.

19. There is no evidence in the record of this proceeding of any shareholder opposition to the proposed transaction.

20. The proposed transaction is an arms-length agreement.

21. The proposed transaction is fair and reasonable to a majority of Lynch's and COTC's shareholders for the reasons set forth in the four previous FOFs.

22. The proposed transaction will not harm the State and local economies or the communities served by Cal-Ore.

23. There is no evidence in the record of this proceeding that the proposed transaction will adversely affect competition.

24. If A.04-05-039 is approved, the shareholders of COTC will realize a net gain from the sale of COTC equal to the sales price of \$21.2 million less any taxes, transaction costs, contingent adjustments to the purchase price, and the shareholders' investment in COTC. There is no record in this proceeding regarding the amount of the shareholders' gain.

25. There is no evidence that ratepayers contributed capital to Cal-Ore.

26. COLD is authorized to provide interexchange service in California pursuant to D.01-04-002. Lynch does not have a CPCN to provide telecommunications services in California.

27. Lynch has a minimum of \$25,000 in cash or cash equivalent.

28. Lynch has sufficient technical expertise to assume control of COLD.

29. The proposed transaction will not result in a change to COLD's name, management, or the rates, terms and conditions of services offered by COLD.

30. Lynch satisfies the Commission's requirements for a CPCN to provide resold interexchange services.

31. Application 04-05-039 does not request, and this Decision does not authorize, authority for new construction or for any changes in the use of existing assets and facilities.

32. The Joint Applicants represent that approval of A.04-05-039 will not result in any changes to Cal-Ore's or COLD's operations or use of existing assets.

33. There were no protests or other responses to A.04-05-039.

Conclusions of Law

1. This is a ratesetting proceeding.
2. There is no need for an evidentiary hearing.
3. Pursuant to § 854(a), no person or corporation may merge, acquire, or control a public utility organized and doing business in California without first securing authorization to do so from the Commission.
4. The purpose § 854(a) is to enable the Commission to review a proposed transaction, before it takes place, in order to take such action as the public interest may require. Where necessary, the Commission may attach conditions to a transaction in order to protect and promote the public interest.
5. Application 04-05-039 is subject to § 854(a). The Commission has broad discretion under § 854(a) to approve or reject A.04-05-039.
6. To insure that the proposed transaction is in the public interest, approval of A.04-05-039 should be subject to the conditions identified in Appendix A.
7. There will be no adverse effect on the Commission's jurisdiction or the Commission's capacity to effectively regulate and audit Cal-Ore's public utility operations if A.04-05-039 is approved with the conditions in Appendix A.
8. Approval of A.04-05-039 does not raise any antitrust or anticompetitive issues that warrant the Commission's intervention.

9. Application 04-05-039 should be granted with the conditions identified in Appendix A.

10. The gain from the sale of COTC should accrue to shareholders in accordance with the precedent established by D.01-06-007 *et al.*

11. Because approval of A.04-05-039 will not have an adverse effect on the environment, the proposed transaction qualifies for an exemption from CEQA pursuant to Section 15061(b)(3)(1) of the CEQA guidelines. Consequently, there is no need for further environmental review of the proposed transaction.

12. The following Order should be effective immediately so that the indirect transfer of control of Cal-Ore and COLD can be completed promptly.

O R D E R

IT IS ORDERED that:

1. Pursuant to Pub. Util. Code § 854, the request for authority to transfer indirect control of Cal-Ore Telephone Co. (Cal-Ore) and Cal-Ore Long Distance, Inc. (COLD), to Lynch Interactive Corporation *et al.* (Lynch) that is set forth in Application (A.) 04-05-039 and the Stock Purchase Agreement appended to A.04-05-039 is granted.

2. This authority granted by this Order is subject to the conditions set forth in Appendix A.

3. The authority granted by this Order shall expire if not exercised within one year from the effective date of this Order.

4. Cal-Ore and COLD shall file with the Commission's Docket Office, for inclusion in the formal file of A.04-05-039, written notice of when the indirect transfer of control of each of these companies has taken place. This notice shall be filed no later than 30 days after the transfer.

5. The gain from the sale of Cal-Ore shall accrue to shareholders.
6. Application 04-05-039 is closed.

This Order is effective today.

Dated _____, at San Francisco, California.

Appendix A

Adopted Conditions

The authority granted by this Decision is subject to following conditions:

1. Lynch Interactive Corporation (Lynch) and California-Oregon Telecommunications Co. (COTC) shall provide Cal-Ore Telephone Company (Cal-Ore) with sufficient equity capital to enable Cal-Ore to (i) maintain a reasonable and balanced capital structure, and (ii) provide service to the public that is safe, reliable, and in compliance with all applicable statutes and Commission orders.
2. Cal-Ore shall establish and maintain a policy for managing its finances on a stand-alone basis, independent of COTC, Lynch, and other affiliates.
3. Cal-Ore shall not loan money, pay a dividend, pay a management fee, or transfer other money to Lynch, COTC, or other affiliates if doing would jeopardize Cal-Ore's ability to provide safe and reliable service to the public at reasonable rates.
4. Cal-Ore shall not record a premium for regulatory accounting purposes, where the premium is the excess of purchase price over book value.
5. Cal-Ore shall not increase rates for its customers due to any increase in costs brought about by the sale/purchase of COTC.
6. Regardless of the amount of debt that Lynch and COTC may decide to allocate to Cal-Ore, the Commission may impute a reasonable and balanced capital structure for Cal-Ore for regulatory accounting and ratemaking purposes.

(END OF APPENDIX A)

CERTIFICATE OF SERVICE

I certify that I have by mail, and by electronic mail to the parties of which an electronic mail address has been provided; this day served a true copy of the original attached Alternate Draft Decision of Commissioner Susan Kennedy on all parties of record for proceeding A.04-05-039 or their attorneys of record.

Dated April 20, 2005 at San Francisco, California.

/s/ CHRISTOPHER V. MEI

Christopher V. Mei

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

The Commission's policy is to schedule hearings (meetings, workshops, etc.) in locations that are accessible to people with disabilities. To verify that a particular location is accessible, call: Calendar Clerk (415) 703-1203.

If specialized accommodations for the disabled are needed, e.g., sign language interpreters, those making the arrangements must call the Public Advisor at (415) 703-2074, TTY 1-866-836-7825 or (415) 703-5282 at least three working days in advance of the event.